STATE OF MINNESOTA

Julie Blaha
State Auditor

Suite 500
525 Park Street
Saint Paul, MN 55103

Statement of Position
TIF Five-Year Rule and Six-Year Rule

The Tax Increment Financing (TIF) Act was amended in 1990 to include a Five-Year Rule and a Six-Year Rule.[1] The general rationale for these Rules was to require an early commitment to the scope of costs needed to facilitate a development so that additional spending is not triggered merely by the availability of an increment revenue stream, and to require earlier decertification to make the new value of development more quickly available to the tax base.[2]

The Five-Year Rule

The Five-Year Rule establishes a "five-year period" whereby activity must occur before or within five years after certification of the district in order to be considered "in-district" expenditures of the district. The Rule works in concert with both the overall pooling restriction, which limits the amount of tax increment that may be used to pay "out-district" expenditures, and the Six-Year Rule, which further restricts pooling and requires districts to be decertified when, generally, sufficient increment has been set aside to pay in-district obligations.[3] Tax increment revenues are considered to have been expended for activities within the district only if one of the following occurs:

1. the revenues are actually paid to a third party within the five-year period;[4]
2. bonds are issued and sold to a third party within the five-year period, tax increment revenues are spent to repay the bonds, and the bond proceeds, in general terms, are expected to be used for the activity within the five-year period;[5]
3. binding contracts with a third party are entered into for performance of the activity within the five-year period and the revenues are spent to satisfy the contractual obligation;
4. activity costs are paid within the five-year period and revenues are spent to reimburse a party for payment of the costs, including interest on unreimbursed costs; or

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[1] Minn. Stat. § 469.1763. The Five-Year Rule and the Six-Year Rule were enacted at the same time and in the same bill as Pooling Restrictions. *See* 1990 Laws of Minn. ch. 604, art. 7, §§ 21, 30 and 31(a).

[2] Minnesota House of Representatives, House Research, Five-Year Rule in TIF.

[3] The overall pooling limit on the amount of tax increment that may be spent "out-district" is 20% or 25% (depending on the type of district), and an election permits an additional 10% of pooling for affordable housing. *See* Minn. Stat. § 469.1763, subd. 2, and the OSA's Statement of Position on TIF Pooling.

[4] A "third party" is an entity that is not the party who benefits from the tax increment assistance and is not the development authority. Minn. Stat. § 469.1763, subd. 1(c).

[5] *See* Minn. Stat. § 469.1763, subd. 3(a)(2). The expectation to use bond proceeds to finance the activity is to be held on the date of issuance and can extend for a "reasonable temporary period" beyond the five-year period within the meaning of the use of the term under Section 148(c)(1) of the Internal Revenue Code. Alternatively, bond proceeds may be deposited in a reasonably required reserve or replacement fund.

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5. expenditures are made for housing purposes at any time during the duration of the district (and not limited to the five-year period).[6]

Expenditures to pay obligations entered into after the first five years, are “out-district” expenditures, even if they are for costs actually incurred within the area of the district. In addition, direct expenditures that are separate from obligations that meet the Five-Year Rule and that occur after the first five years are “out-district” expenditures even if they are spent within the area of the district.

The Five-Year Rule extends for five years from the date of certification of the TIF district. For example, a district certified July 5, 2022, would have its five-year period end on July 5, 2027. The period runs from the actual certification date, not the request for certification date or the approval date.

For redevelopment districts or renewal and renovation districts that were certified after June 30, 2003, and before April 20, 2009, the Legislature extended the Five-Year Rule to ten years.[7] For redevelopment districts that were certified after April 20, 2009, and before June 30, 2012, the Five-Year Rule was extended to eight years.[8] For redevelopment districts that were certified after December 31, 2017, and before June 30, 2020, the Five-Year Rule was also extended to eight years.[9]

Only the “revenues derived from tax increments paid by properties in the district” are subject to the Five-Year Rule (and the Six-Year Rule).[10] Proceeds from the sale or lease of property purchased with tax increments, principal and interest received on loans or advances made with tax increments, interest or other investment earnings on or from tax increments, and repayments to an authority are not subject to the Rules, even though they are all tax increments.[11]

The Six-Year Rule

In the sixth year following certification of the district, and in each year after, if the in-district percentage of the tax increment received from the county exceeds the costs spent on in-district obligations that year, the excess must be used only to pay or defease the following or be set aside to pay the following:

1. outstanding bonds and contracts that meet the Five-Year Rule test for being activities within the district;
2. credit enhanced bonds to which tax increment was pledged, but only to the extent that revenues of the district to which the credit enhanced bonds were issued are insufficient to pay the bonds and to the extent that the increments from the applicable pooling percentage share for the district are insufficient; or

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[6] Minn. Stat. § 469.1763, subd. 3.
[7] Minn. Stat. § 469.1763, subd. 3(c).
[8] Minn. Stat. § 469.1763, subd. 3(c). The effective date for this extension also requires that the request for certification be made after April 20, 2009. Both of extensions in subdivision 3(c) were provided to accommodate delays in development activities that occurred in the Great Recession.
[9] Minn. Stat. § 469.1763, subd. 3(d). The effective date for this provision also requires that the request for certification be made after December 31, 2017. This extension was provided to accommodate delays in development activities due to the COVID-19 pandemic.
[10] Minn. Stat. § 469.1763, subd. 1(d). The definition’s reference to “taxes paid by the captured net tax capacity” includes both distributions of tax increment collections by the county (the net amount paid by property owners) and any TIF credit distributions reimbursing the reductions of the gross taxes on captured value.
[11] Tax increment revenues as defined in Minn. Stat. § 469.174, subd. 25(2), (3), and (4) are expressly excluded from “revenues derived from tax increment paid by properties in the district.” *See* Minn. Stat. § 469.1763, subd. 1(d).

3. expenditures authorized in the TIF plan for housing projects.[12]

By requiring the in-district percentage of tax increment to be used for these purposes in each year, the TIF Act subjects pooling to an annual limit in addition to the overall or cumulative limit.

The TIF district must be decertified, and any pledge of tax increment to bonds discharged, once the outstanding bonds have been defeased and sufficient money has been set aside to pay for:

1. outstanding contractual obligations under the Five-Year Rule;
2. housing projects specified in the TIF plan; and
3. the additional expenditures permitted by the TIF plan under an election to pool increment for qualified low-income housing.[13]

Authorities should annually monitor the need to decertify a district under this requirement of the Six-Year Rule and notify the county auditor of any need to decertify the district. Adopting a decertification resolution and completing the Office of the State Auditor's Confirmation of Decertified District Form are required to comply with this provision.

[12] *See* Minn. Stat. §§ 469.1763, subd. 3(a).
[13] Minn. Stat. § 469.1763, subd. 4(b) and subd. 2(d).

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